

Report of the auditor-general to the Free State Legislature and the council on the Naledi Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Naledi Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. The municipality did not review the residual values and useful lives as well as perform an impairment assessment of infrastructure assets at each reporting date in accordance with SA Standards of GRAP, GRAP 17 *Property, plant and equipment* and SA Standards of GRAP, GRAP 26 *Impairment of cash-generated assets*. I was not able to determine the correct net carrying amount of infrastructure assets as it was impracticable to do so. Furthermore, not all infrastructure assets accounted for in the asset register could be verified, and some infrastructure assets and land were not included in the asset register. I was unable to confirm buildings, community and infrastructure assets by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary relating to buildings stated at R23 226 643 (2014: R23 938 406), community assets stated at R57 154 724 (2014: R38 237 739) and infrastructure assets stated at R198 642 505 (2014: R208 243 141) in note 9 to the financial statements.

Consumer receivables

7. I was unable to obtain sufficient appropriate audit evidence regarding receivables from exchange transactions due to the inadequate management of consumer debtors on the financial system. I was unable to confirm the receivables by alternative means. Consequently, I was unable to determine whether any adjustment was necessary relating to the gross receivables from exchange transactions stated at R62 334 431 (2014: R49 539 198) in note 4 to the financial statements and the net balance stated at R1 725 181 (2014: R2 992 123) in the statement of financial position.

Service charges

8. During 2014, I was unable to obtain sufficient appropriate audit evidence regarding the sale of water included in service charges, due to the inadequate capturing of consumption information on the financial system. I was unable to confirm the sale of water by alternative means. Consequently, I was unable to determine whether any adjustment was necessary relating to the sale of water stated at R6 062 691 in note 18 to the financial statements. My opinion of the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Irregular expenditure

9. The municipality did not disclose all irregular expenditure in the notes to the financial statements, as required by section 125(2)(d)(i) of the MFMA. The municipality incurred expenditure in contravention of supply chain management (SCM) requirements. I was not able to determine the impact on irregular expenditure disclosed in note 43 to the financial statements as it was impracticable to do so.

Qualified opinion

10. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Naledi Local Municipality as at 30 June 2015 and

its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

11. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

12. As disclosed in note 47 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2014-2015 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

Material losses

13. As disclosed in note 30 to the financial statements, material electricity and water losses of R19 810 509 (2014: R3 470 347) and R5 047 849 (2014: R6 432 224), respectively, were incurred as a result of line losses, tampering and theft.

Material impairment

14. As disclosed in note 4 to the financial statements, a provision for impairment of debtors of R60 609 250 (2014: R46 547 075) has been made with regard to consumer debts of R62 334 431 (2014: R49 539 198).

Going concern

15. Note 39 to the financial statements indicates that the municipality is experiencing financial difficulties. Indicators include suppliers not paid within the required number of days, unspent conditional grants not backed by available cash and a slow collection and low recoverability of outstanding consumer accounts. These conditions, along with other matters as set forth in note 39, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Additional matter

16. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

17. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

18. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected

key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - Key performance area 1: basic services and infrastructure development, on pages x to x
20. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
21. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. The material findings in respect of the selected key performance areas are as follows:

Basic services and infrastructure development

Usefulness of reported performance information

24. Section 41(c) of the Municipal Systems Act, 2000 (Act No.32 of 2000)(MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 70% of the reported objectives, 41% of the indicators and 43% of the targets were not consistent with those in the approved integrated development plan. This was due to objectives, indicators and targets not being monitored throughout the year to ensure consistency between planned and reported information.
25. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 41% of the indicators were not well defined.
26. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicators were not verifiable.

27. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 35% of the targets were not specific.
28. Performance targets should be measurable as required by the FMPPI. I could not measure the required performance for 35% of the targets.

The above was due to a lack of proper systems and processes for predetermined objectives.

Reliability of reported performance information

29. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work, as the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matter

30. I draw attention to the following matter:

Achievement of planned targets

31. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance area reported in paragraphs 24 to 29 of this report.

Compliance with legislation

32. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

33. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
34. The annual performance report for the year under review did not include measures to improve performance as required by section 46(1)(c) of the MSA.

Financial statements, performance report and annual report

35. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material

misstatements of non-current assets, current assets, liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Audit committees

36. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the municipality, its efficiency and effectiveness as well as its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.
37. The audit committee did not respond to the council on the issues raised in the audit reports of the auditor-general, as required by section 166(2)(c) of the MFMA.
38. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by municipal planning and performance management regulation 14(4)(a)(ii).
39. The audit committee did not submit, at least twice during the financial year, a report on the review of the performance management system to the council, as required by municipal planning and performance management regulation 14(4)(a)(iii).
40. The audit committee was not constituted, in the manner required by section 166(4)(a) of the MFMA, as the audit committee did not consist of at least three persons.
41. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit

42. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
 - it did not report to the audit committee on the implementation of the internal audit plan
 - it did not advise the accounting officer and report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management, and loss control.
43. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Procurement and contract management

44. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, contrary to SCM regulation 17(a) and (c).
45. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, contrary to SCM regulation 19(a).

Human resource management and compensation

46. The municipality did not submit a report on compliance with the prescribed competency levels to the National Treasury and relevant provincial treasury, as required by municipal regulations on minimum competency levels 14(2)(a).
47. The annual report of the municipality did not reflect information on compliance with the prescribed minimum competencies, as required by the municipal regulations on minimum competency levels 14(2)(b) and 14(3).

Expenditure management

48. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
49. Reasonable steps were not taken to prevent unauthorised, irregular expenditure as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

50. The municipality did not evaluate its performance in respect of programmes or functions funded by the municipal systems improvement grant and local government finance management grant allocation, as required by section 12(5) of DoRA.
51. The municipal infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.

Revenue management

52. An adequate management, accounting and information system was not in place to account for revenue, debtors and receipts of revenue, as required by section 64(2)(e) of the MFMA.
53. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
54. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

55. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
56. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

57. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Internal control

58. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

59. There was a slow response by the leadership to the messages communicated by the auditor-general. This resulted in a lack of adequate processes and controls to ensure the reliability and validity of financial and performance information as well as compliance with legislation.
60. Some critical vacancies existed during the year, which also had an impact on the implementation of effective internal controls and the action plan.

Financial and performance management

61. Due to a slow response by management to hold staff accountable, various daily and monthly controls and reconciliations were not performed during the year. A lack of capacity resulted in high reliance being placed on the work of consultants without their work being properly monitored or ensuring that proper internal control processes, especially regarding assets, were implemented.
62. A history of a lack of consequences also resulted in weak measures to monitor compliance with legislation, resulting in the recurrence of non-compliance that could have been prevented.
63. A lack of competencies was identified, especially in the SCM unit, contributing to the occurrence of irregular expenditure.

Governance

64. The audit committee was not sufficiently capacitated and did not promote accountability and service delivery by evaluating and monitoring responses to risks and by providing oversight of the effectiveness of the internal control environment.
65. As the internal audit unit was not adequately capacitated and functioning, the unit did not assist management in evaluating internal controls to determine the effectiveness

and efficiency thereof.

Auditor-General
Bloemfontein

30 November 2015



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